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79-2838/1

18 December 1979

MEMORANDUM FOR: Director, Central Intelligence
Deputy Director, Central Intelligence

VIA : Director, National Foreign Assessment Center

FROM : [redacted] 25X1
Acting Director, Economic Research

SUBJECT : Impact of Disproportionate US Sharing of an Oil Supply Shortfall

1. Action Requested: None; this is in response to your request of 10 December 1979 for an analysis of the impact of the United States absorbing a disproportionate share of an Iranian oil export shutdown. [redacted] 25X1

2. Background: OER's recent assessment of the economic implications of a complete shutdown in Iranian oil exports indicated that a 2 million b/d shortfall in world oil supplies throughout 1980 would just about eliminate the chances for Free World economic growth next year. With oil prices being driven to $40 per barrel, real GNP in the OECD would fall 1 percent, while inflation would hit almost 13 percent. The non-OPEC less developed countries would see real growth slow to the lowest rate in 20 years and inflation increase to 50 percent. [redacted] 25X1

3. In our analysis, we did not explicitly allocate the supply loss to specific countries. We assumed the shortfall would be shared based on historical consumption patterns. Because of the importance of oil imports in overall US energy usage, the United States implicitly absorbed 0.8 million b/d of the 2 million b/d supply loss. [redacted] 25X1

4. The United States could introduce policies to absorb a disproportionate share of the supply shortfall. This would require higher taxes on energy consumption, direct allocation schemes, or monetary/fiscal policies designed to slow economic growth. Regardless of how it is accomplished, a reduction in US oil imports would tighten supplies of key petroleum products -- particularly gasoline, aviation fuels, and home heating oil. Studies of the supply

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stringencies induced by the Iranian crisis of early 1979, when the worldwide shortfall reached 1-2 million b/d, indicate that the tourist and transportation sectors of the US economy were particularly hard hit. [redacted] 25X1

The Price Method

5. The United States could chose to absorb one half of the 2 million b/d cutback in Iranian production solely through higher energy prices. This could be done in two major ways:

- o Imposing import quotas and auctioning off entitlement tickets. To make this option viable domestic product price controls would have to be lifted or at least modified to allow higher crude costs to be passed onto energy users.

- o Levying selected taxes on specific energy products.

If the United States chose the import quota route, US oil prices would have to rise to $47 per barrel instead of $40 per barrel. Because the United States would be taking pressure off the international oil market by its actions, our allies would face an oil price of less than $40 per barrel. [redacted]

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6. With US oil prices at $47 per barrel, we calculate that the US GNP would decline 2.8 percent in 1980, compared with the baseline of -2.4 percent presented in our original report that assumed $40 per barrel oil prices; inflation would rise 0.4 percentage points to 12 percent. [redacted] 25X1

7. If the United States opted for the selective tax route, foreign pressures would also be eased, but the US domestic effects could be noticeably different. While an import quota would raise the cost of oil products to all consumers, a selective tax would place the adjustment burden more heavily on selected groups. A decision to substantially boost gasoline excise taxes, for example, would force motorists to reduce fuel usage. [redacted] 25X1

Alternative Methods

8. The United States could opt to reduce oil consumption by directly allocating supplies to critical areas of the economy. This could also be done in two major ways:

- o Maintain, and strictly enforce, existing price controls and allocative regulations.

- o Introduce rationing or other administrative allocation systems.

Rigid adherence to current government regulations would almost certainly guarantee that the US would have to bear a disproportionate share of any worldwide oil shortfall. US domestic price controls would provide a strong incentive to multinational oil companies to shift oil deliveries to more lucrative foreign markets. If this option were chosen the oil stringency would affect the economy much as it did in early 1979. Existing supplies would be allocated through a combination of gasoline lines and administrative decisions.

25X1 [redacted]

9. While rationing schemes might temporarily ease the economic impact of a supply shortfall, we do not know how much -- or even if -- these savings would avoid slowing US economic growth. US oil consumption is already 1.8 percent below last year's levels -- a savings of 300,000 b/d -- mainly reflecting reduced gasoline consumption. Further cuts in gasoline use will prove painful, since the present decline in usage mainly reflects a reduction in discretionary driving. Reductions in consumption of distillate and residual fuels also largely reflect one-time conservation measures and some substitution of coal and natural gas for heat and power production. [redacted] 25X1

Impact Abroad

10. A US decision to shoulder a disproportionate share of the oil shortfall would ease pressures on the world oil market, reducing the decline in economic growth in the rest of the OECD and permit slightly greater growth in the non-OPEC LDCs. Oil prices outside the United States would rise to $37 per barrel abroad, compared with the $40 price that allies would face in the absence of greater US conservation.

At $37 per barrel, we estimate that non-US OECD GNP would rise 0.7 percent in 1980 instead of the 0.3 percent that would be expected with prices at $40. This calculation includes income losses abroad caused by the above average reduction in US economic growth. [redacted] 25X1

[redacted] 25X1

Acting Director
Economic Research

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NFAC # 6686-79

10 December 1979

MEMORANDUM FOR: Director of Economic Research

FROM: Director of Central Intelligence

SUBJECT: Study on Impact of Iranian Oil Export Shutdown

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1. I just read your latest monograph on the global impact of a complete shutdown of the Iranian oil exports. It is an excellent piece of work and I want to compliment you and your entire Office on the large number of highly relevant pieces of economic analysis you've been turning out during this Iranian crisis. I personally delivered this latest one to Secretary Vance on 8 December in preparation for his trip to Europe.

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2. In this study you assume that there are not any major reductions in consumption. If Iranian production is cut off due in large measure to our conflict with them (but regardless of whether we cut it or they cut it), could the United States simply offer to absorb some large fraction of the Iranian reduction by reducing its imports? In short, could we use this as a spur to our domestic conservation program by simply forcing ourselves to eat it and in the same process to cut the pressure on the world market? Is that a possible alternative?

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